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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-1789

MR. STEAK, INC., and
CENTRAL BANK AND TRUST COMPANY,
Petitioners,

v.

EDINA STATE BANK,
Respondent.

MOTION OF THE STOCK TRANSFER ASSOCIATION, INC., FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF OF THE STOCK TRANSFER ASSOCIATION, INC., AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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June 4, 1974

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MOTION OF THE STOCK TRANSFER ASSOCIATION, INC., FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

The Stock Transfer Association, Inc. ("Association"), respectfully moves this Court for leave to file the accompanying brief as amicus curiae in this case. The attorneys for the Petitioners have given their consent to the filing of such brief, but the attorneys for the Respondent have refused to give such consent.

The nature of the Association's interest in this case is set forth in the accompanying brief.

The Association believes that the questions of law, in light of important policy concerns of the Securities Act of 1933, as amended, and equally important responsibilities of issuers and transfer agents of securities thereunder, are not adequately presented in the brief filed by the Petitioners in the United States Court of Appeals for the Tenth Circuit or in the Petition.

The Association believes that the views which it wishes to present to this Court will contribute to a proper resolution of such questions and to the ultimate public good. If such views should be adopted by this Court, the decision below must be reversed.

WHEREFORE, the Association respectfully requests leave to file the accompanying brief as amicus curiae.

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BRIEF OF THE STOCK TRANSFER ASSOCIATION, INC., AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Interest of The Stock Transfer Association, Inc.

The Stock Transfer Association, Inc. ("Association"), is a sixty-year-old organization now existing as a corporation under the Not-For-Profit Corporation Law of the State of New York. Its members are individual representatives of (a) banks and trust companies and other organiza-

tions which act as independent, or professional, transfer agents, (b) corporate issuers which transfer their own securities and (c) other organizations involved, in one way or another, in the security transfer field. The Association has more than 400 regular members throughout the United States and Canada, is managed by an elected board of 18 directors and operates through a number of standing committees. In an advisory and educational capacity, the Association is dedicated to the development and improvement of the security transfer process. Over many years, it has developed rules for the transfer of securities which have brought about greater uniformity in the procedures of transfer agents and which have had considerable effect on expediting and simplifying the transfer of securities.

The Association holds an annual meeting during which there is intensive discussion for a three-day period of various matters of importance in the security transfer field. The Association also holds other regular meetings, and its Board of Directors and standing committees meet regularly, in both the United States and Canada.

The Association has a serious interest in a review by this Court of the decision of the United States Court of Appeals for the Tenth Circuit. This decision, if left undisturbed, will subject issuers and transfer agents throughout the United States and Canada to unreasonable responsibilities in similar cases and will perpetuate a nationwide lack of uniformity in what the Association strongly believes to be the proper approach to the questions involved.

Question Presented

In its broadest sense, the question presented by this case is whether the policy concerns embodied in Section 5 of the Securities Act of 1933, as amended ("Act"), 15 U.S.C. § 77e (1970), that "Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly ... in interstate commerce ... to sell such security ...." shall yield to considerations affecting private rights of individuals under state law.

Narrowly stated, such question is whether a failure on the part of an issuer to place on the certificates representing any "unregistered" securities under the Act a conspicuous notation to the effect that transfer of such securities is restricted by the Act should subject such issuer and its transfer agent to liability for damages under Section 8-401 of the Uniform Commercial Code for a refusal to register a transfer to a person without actual knowledge of such restriction.

Statement of the Case

This is an action brought by Edina State Bank ("Edina") against Mr. Steak, Inc. ("Mr. Steak"), and Mr. Steak's transfer agent, Central Bank and Trust Company ("Central"), for damages resulting from the alleged wrongful refusal of Mr. Steak and Central to register transfer, following a sale, of 1,000 shares of stock in Mr. Steak which Edina had accepted as part of a pledge of collateral for a series of loans made by Edina to Price, an

employee of Mr. Steak at the time of issuance. Initially, 200 shares, which were not registered under the Act, had been issued to Price, pursuant to the "private offering" exemption available to Mr. Steak under Section 4(2) of the Act, 15 U.S.C. § 77d(2) (1970). The stock pledged comprised 2400 shares representing a subsequent 12-for-1 stock dividend. The stock certificate evidencing the 2400 pledged shares bore no legend. Price had been advised at the time of issuance, and subsequently reminded, that the stock was "restricted" but told Edina at the time of the initial loan that the stock was not "restricted". Price was not able to discharge his indebtedness to Edina; and Edina sold, but was subsequently forced to rescind the sale of, 1,000 of the pledged shares. Rescission resulted from the refusal of Mr. Steak and Central to register the transfer without a "no action" letter from the Securities and Exchange Commission or an opinion of counsel that the transfer did not violate the Act.

In the District Court for the District of Colorado, Edina argued that, in accordance with Section 8-204 of the Uniform Commercial Code in effect in Colorado, Colo. Rev. Stat. ch. 155, § 155-8-204 (1963), any restriction on transfer, even a restriction imposed by reason of the Act, was ineffective because Edina did not have actual knowledge of the restriction. Mr. Steak and Central maintained that the prohibitions of the Act were an absolute bar to registration of the transfer. The factual arguments of the parties, which were made in the context of the foregoing opposing views, will be discussed in an amicus curiae brief on the merits, should the Petition be granted.

The District Court, finding a conflict between Section 8-204 and the prohibitions of the Act, which does not im-

pose on an issuer any requirement to place a restrictive legend on certificates representing securities issued pursuant to an exemption available under the Act, ruled in favor of Mr. Steak and Central on the ground that the rights and obligations of the parties were controlled by the Act, since the federal government had preempted the field.

The United States Court of Appeals for the Tenth Circuit reversed and remanded for further proceedings and judgment on the quantum of damages. It held that, since Edina had not requested injunctive relief compelling registration of the transfer, Section 8-204 "may be read in harmony with the [Act]" and that, in the circumstances of this case, the "strict requirement" of Section 8-204, namely, that the issuer note conspicuously on the certificate any restriction on transfer, supported Edina's right to recovery of damages under Section 8-401 by reason of Mr. Steak's and Central's refusal to register the transfer.

Reasons for Granting the Writ

The Association believes that the decision below raises a very serious question of federal law which should be settled by this Court. The Association shows in this brief that the decision, which places the private rights of individuals under the Uniform Commercial Code above the salutary purposes of the Act, imposes on issuers and transfer agents unreasonable responsibilities under the Act in connection with the flow of securities in the nation's marketplaces. The Association strongly believes that the merits of this case, particularly the issues involving the

respective duties of Edina, as pledgee, and Mr. Steak and Central, as issuer and transfer agent, respectively, deserve review by this Court.

A. This case presents a clear conflict between the purposes of the Securities Act of 1933 and the Uniform Commercial Code.

It is undeniable that a principal purpose of Article 8 of the Uniform Commercial Code is to confer "full negotiability" on investment securities, *see Edina State Bank v. Mr. Steak, Inc.*, 487 F.2d 640, 643 n.4 (10th Cir. 1973), and that that is the reason behind Section 8-204. It is also undeniable that impugning the title of a good faith purchaser of an investment security without knowledge is a serious matter. Nevertheless, the Association submits that the very considerable mandate of Section 5 of the Act that no security be sold in interstate commerce in the absence of an effective registration statement as to such security is of overriding national concern. Before such concern be made to bow to private rights of individuals under state law on the imposing authority of the decision below, the conflict should be reviewed by this Court.

The District Court in this case clearly saw the conflict between Section 8-204 of the Uniform Commercial Code and Section 5 of the Act. In resolving such conflict, the District Court determined that the Act must prevail. The Association strenuously supports such determination.

As noted by both the District Court and the court below, there is no substantive requirement under the Act that "unregistered" securities bear a restrictive legend. How-

ever, the Securities and Exchange Commission has stated that restrictive legends serve an important policing function and has indicated that the presence or absence of "an appropriate legend", together with the presence or absence of stop-transfer instructions issued to any transfer agent and a statement of the initial purchaser's investment intent, will be regarded "as a factor in considering whether the circumstances surrounding the offering are consistent with the exemption under Section 4(2) of the Act" [transactions by an issuer not involving any public offering], which "is essentially a question of fact". Sec. Act Rel. 5121, 36 Fed. Reg. 1525 (1970). *See also* Sec. Act Rel. 4552, 27 Fed. Reg. 11316 (1962). The Commission has emphasized the evidentiary nature of such a legend and the fact that the legend is not to be regarded as a basis for the exemption. *Id.*

While it would certainly be desirable that in every "private offering" situation securities taken "for investment" be legended, as a practical matter, legending is not always possible. For example, thousands of small private issuers are often unable to call in their privately held certificates for legending when they "go public"; and the most that such issuers can be expected to do is to remind their existing stockholders and their transfer agents that the outstanding stock is "restricted". These issuers, which can be found throughout the United States, must be permitted, with impunity, to refuse to register a transfer otherwise mandated under state law when the transfer, even to a purchaser without actual knowledge of any restriction, could subject them to penalties for violation of the Act and, in fact, directly vitiate the purposes of the

Act. The Association fails to find in Section 8-204, or any similar state statute, sufficient justification for a rule of law which can subject an issuer or its transfer agent to such penalties.

Perhaps more troublesome than the difficulties surrounding the unlegended "investment" security are the problems attendant upon the transfer of securities by "control" persons, or affiliates. It is well known that it is often impossible to legend certificates acquired by "control" persons; and an issuer or transfer agent may be implicated in a violation of the Act if required to register a transfer to a purchaser without knowledge of the "control" relationship. Again, the most that an issuer may be able to do in connection with securities held by "control" persons is to notify its known "control" persons and issue stop-transfer instructions to its transfer agent. *See* 1 L. Loss, *Securities Regulation* 2654 (2d ed. Supp. 1969) [hereinafter cited as *Loss*]; Israels, *Problems Incident to Use of Stop-Transfer Procedures, Current Problems of Securities Underwriters and Dealers*, 18 Bus. Law. 27, 85-89 (1962); § 8-204, Comment 3, where the unexplained suggestion is made that, in the absence of a restrictive legend, the issuer may refuse to register a transfer out of the name of a "control" person, "relying on the stated exception as to a person 'with actual knowledge' of the restriction."

The decision below does not resolve the conflict between the purposes of the Act and the Uniform Commercial Code and ignores the very serious practical reasons why the rule enunciated is not workable. For these reasons, the decision below should be reviewed by this Court.

B. Prior reported decisions bearing on the question presented are conflicting and create a background of legal uncertainty for issuers and transfer agents.

There is, of course, ample support throughout the several states for the proposition that an issuer or transfer agent may, at least temporarily, refuse to register a transfer of securities if the grounds for such refusal are "reasonable". *See generally* 1 F. Christy, *The Transfer of Stock* § 263 (5th ed. 1972); 1 *Loss, supra* at 2657; 18 Am. Jur. 2d *Corporations* § 416 (1965); Uniform Commercial Code § 8-401; *Travis Investment Co. v. Harwyn Publishing Corporation,* 288 F. Supp. 519, 526 (S.D.N.Y. 1968); *Kanton v. United States Plastics, Inc.,* 248 F. Supp. 353, 362-63 (D.N.J. 1965); *Branerton Corporation v. United States Corporation Company,* 34 App. Div. 2d 1, 3, 309 N.Y.S.2d 28, 29 (1970), *motion for leave to appeal dismissed,* 27 N.Y. 2d 722, 262 N.E.2d 670, 314 N.Y.S.2d 529; *Hillary Holding Corporation v. Brooklyn Jockey Club,* 88 N.Y.S.2d 198 (Sup. Ct. 1949). The question which has given rise to so much uncertainty, and which should now be reveiwed by this Court, is whether the fact that a transfer may result in violation of the Act is such a reasonable ground, even where the purchaser has no actual knowledge of any such restriction.

In *Travis Investment Co. v. Harwyn Publishing Corporation,* 288 F. Supp. 519 (S.D.N.Y. 1968), a case which arose before the Uniform Commercial Code became effective in New York but decided under similar propositions of law, the court held that a refusal on the part of an issuer and its transfer agent to register a transfer of securities, pending the receipt of further information as to ownership and control, was reasonable even as against a pledgee which was

arguably in good faith and without notice, where the issuer and transfer agent had been alerted by the Securities and Exchange Commission that stock of the issuer might be sold in the market by persons in a "control" relationship with the issuer. The *Harwyn Publishing* case was followed in *Branerton Corporation v. United States Corporation Company*, 34 App. Div. 2d 1, 309 N.Y.S.2d 28 (1970), a case also involving possible violation of the Act but in connection with securities originally taken "for investment". In *Branerton*, decided under the Uniform Commercial Code, the court reversed an order which had granted the plaintiff, also a pledgee which was arguably in good faith and without notice, summary judgment against a transfer agent for damages for refusal to register a transfer (the issuer having since the commencement of the action gone into Chapter XI proceedings) and remarked:

> "[D]efendant could well have been under a prohibition against transferring the stock. Whether or not plaintiff was aware of the restriction does not appear conclusively, but even if it was not it is not determinative (*Travis Inv. Co.* v. *Harwyn Pub. Corp.*, 288 F. Supp. 519, 526). The issue is whether the transfer agent had reasonable grounds for belief that the transfer would be one forbidden by law. Whether that belief was engendered by a positive statement from the SEC, as in the *Harwyn* case, or came from other sources may go to the weight of the claim that the belief existed, but it certainly does not establish the contrary." 34 App. Div. 2d at 3, 309 N.Y.S.2d at 29-30.

The cases have clearly established that a belief on the part of an issuer or its transfer agent that a transfer may be in violation of the Act must be bona fide and not merely an excuse for a refusal to register a transfer based on other

considerations. *See Kanton v. United States Plastics, Inc.*, 248 F. Supp. 353, 358 (D.N.J. 1965) ("This Court is satisfied that the refusal of both [the transfer agent] and [the issuer] to make the requested transfer of plaintiff's stock was based, not on any fear of criminal sanctions under the Securities Act of 1933, but on orders from [the issuer's president] that the requested transfer was not to be made."); *see also Riskin v. National Computer Analysts, Inc.*, 62 Misc. 2d 605, 308 N.Y.S.2d 985 (Sup. Ct. 1970), *modified*, 37 App. Div. 2d 952, 326 N.Y.S.2d 419 (1971).

To be contrasted with the decisions in *Harwyn Publishing* and *Branerton* is *Welland Investment Corporation v. First National Bank*, 81 N.J. Super. 180, 195 A.2d 210 (Super. Ct. Ch. 1963). In that case, decided under the Uniform Commercial Code, which involved an action brought against an issuer and its transfer agent to compel the transfer of, and for damages for wrongful refusal to transfer, securities originally taken "for investment", the court paid only passing attention to the issuer's stated concern that the requested transfer might violate the Act. The court denied the plaintiff's motion for summary judgment, holding that the sole issue, namely whether the plaintiff, a pledgee, was, in fact, in good faith and without notice, had to await a plenary hearing. *See also Prudential Petroleum Corporation v. Rauscher, Pierce & Co.*, 281 S.W.2d 457 (Tex. Civ. App. 1955), decided under the Uniform Stock Transfer Act; *General Development Corporation v. Catlin*, 139 So. 2d 901 (Fla. Dist. Ct. App. 1962), also decided under the Uniform Stock Transfer Act.

The decision below, avoiding as it does the question which would be presented if Edina had requested injunc-

tive relief directing registration of the transfer, not only does not pay proper heed to the importance of the Act but also does not dispel the existing legal uncertainty surrounding the question presented. For this additional reason, this Court should review the decision below.

C. A restriction imposed by reason of the Securities Act of 1933 should not be construed as a restriction "imposed by the issuer" under Section 8-204 of the Uniform Commercial Code.

The Association submits that the restrictions imposed on securities by the Act, that is, restrictions inhering in "investment" securities or securities held by "control" persons, are restrictions in consequence of substantive federal law. Such restrictions are, therefore, public rather than private in nature and are not, and should not be viewed as, restrictions "imposed by the issuer" within the meaning of Section 8-204.

It is believed that the District Court clearly understood the public nature of the restrictions which inhere in "investment" securities and, in fact, based its decision thereon. At pages 100-01 of the trial transcript, the District Court remarked to counsel for Edina,

> "I must add though why do you say what you do, in effect, that the restriction against transfer was imposed by the issuer rather than to say the restriction on transfer was imposed by the Congress of the United States."

Further, it is believed that the District Court's remarks in its Findings of Fact and Conclusions of Law, Petition for Certiorari at xvi, *Mr. Steak, Inc. v. Edina State Bank*, No. 73-1789 (filed May 29, 1974),

> "We may consider the Uniform Commercial Code in considering the disposition of this case, but insofar as the disposition of this case is governed by the Securities Act of 1933 as amended, the Federal Government has pre-empted the field and to the extent that there is a conflict between the Securities Act of 1933 and the application of the Uniform Commercial Code in the circumstances of this case, it is the Securities Act which will prevail and which the Court will consider."

must be interpreted to illustrate the District Court's view that restrictions which arise by reason of the Act are not privately created under applicable state law but exist as an important part of a broad scheme of federal regulation.

The Official Comment to Section 8-204 demonstrates that the restrictions contemplated by that Section are, in the main, the private restrictions on free transferability traditionally available to issuers, within the limits of applicable state law, for the furtherance of legitimate corporate purposes. Comment 2 indicates, for example:

> "Most jurisdictions recognize the right of issuers to impose restrictions giving either the issuer itself or other stockholders the option to purchase the security at an ascertained price before it is offered to third parties. [citations omitted] This is the type of restriction contemplated by the present section."

And Comment 4 states:

> "This section deals only with restrictions imposed by the issuer and restrictions imposed by statute are not affected." [citations omitted]

While a restrictive legend keyed to the prohibitions of the Act unquestionably would be within Section 8-204, and would, therefore, directly affect the right of a purchaser

under applicable state law to registration of the transfer free of the legend, it must be emphasized that such a restrictive legend should be viewed merely as a device supplementing an issuer's general effort to act in concert with national policy. In the language of Comment 3,

> "[Restrictions on transfer] are being increasingly resorted to today by issuers with publicly held securities seeking to police enforcement of the registration requirements of the Securities Act of 1933 against persons purchasing their securities in a transaction exempt from those requirements ... or against persons in a 'control' relationship to the issuer."

Hence, although the issuer clearly has a private interest in the application of a restrictive legend, the legend is not, in the strict sense, "imposed by the issuer", within the contemplation of Section 8-204. Rather, the restrictive legend is publicly imposed and exists as a creature of statute, not as a creature of private interests.

The Association, therefore, requests this Court to review the decision below, because a proper construction of Section 8-204 in the circumstances of this case is warranted.

Conclusion

The Association strenuously urges this Court to grant the Writ. A decision by this Court will resolve an unfortunate conflict arising under the Act and will foster nationwide uniformity in approach to the questions involved.

The decision below does not resolve such conflict. It will only perpetuate an undesirable and continuing case-by-case analysis on the part of issuers and transfer agents as

to whether, in the particular circumstances, there are not some factual reasons why the issuer or the transfer agent may safely risk a refusal to transfer. Issuers and transfer agents deserve greater guidance in connection with their important responsibilities under the Act. The dilemma, which has been appropriately acknowledged by Professor Loss, 1 *Loss, supra* at 2658,

> "[I]t is not a proposition unique to §5 of the Securities Act that the issuer (or its transfer agent) may in either event guess wrong at the issuer's peril (if not the transfer agent's as well)—whether it improperly registers a transfer or improperly declines to do so."

should not exist.

For all of the foregoing reasons, the Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit should be granted.

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June 4, 1974

Certificate of Service

I, Arthur H. Christy, one of the attorneys for The Stock Transfer Association, Inc., as amicus curiae herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that, on the 4th day of June, 1974, three true and correct copies of the foregoing Motion and Brief to the Supreme Court of the United States were served on each of the following parties by mailing such copies in duly addressed envelopes, with first-class air-mail postage prepaid, to:

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